INFORMATION REPORT

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	April 11, 2016
SUBJECT/REPORT NO:	Reserve/Revenue Fund Investment Performance Report – December 31, 2015 (FCS16028) (City Wide)
WARD(S) AFFECTED:	City Wide
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Council Direction:

Not Applicable.

Information:

The investment portfolio for the City of Hamilton's (City's) Reserve/Revenue Fund (comprised of reserve/revenue funds, capital account balances and unused operating funds) had an earnings rate of 2.83% for the 12 months ending December 31, 2015, and had an average earnings rate of 2.96% over the past five years. The earnings rate includes interest and lending revenues, but excludes realized and unrealized capital gains/losses.

The City's portfolio generated $26,641,484 in bond interest, net realized capital gains/losses, lending revenue and bank interest over the 12 months ending December 31, 2015. The average dollar amount generated over the last five years is $26.56 million. The return of $26,641,484 was realized on an average asset cost of $946,066,995 (made up of $772,099,022 for the investment portfolio plus $167,771,823 for the City's bank account balance plus $6,196,150 for the One Fund Equity), giving a percentage return on cost of 2.82%. Bond lending revenues of $130,191 are included in the earnings rate of 2.83%. Net unrealized capital gains/losses were $35,116,608 as at December 31, 2015.

For the 12 months ending December 31, 2015, the overall return (includes bond interest, bond lending revenues, realized capital gains/losses and unrealized capital gains/losses) was 3.56% and the return on the benchmark was 2.72%, resulting in an outperformance of 84 basis points. Over the past five years, the overall return has averaged 3.82% per annum, outperforming the average return on the benchmark over the same five-year period of 2.96% by 86 basis points. For the one year period ending December 31, 2015, the outperformance of the investment portfolio relative to the benchmark is attributed to its longer duration resulting in mid-term and long-term bonds outperforming short-term bonds given the persistent and significant decrease in bond yields in 2015.

By comparison, the overall returns for the One Fund portfolios (offered by the Association of Municipalities of Ontario and the Municipal Finance Officers' Association), over the 12 month period ending December 31, 2015 were 1.94% for bonds and 0.67% for money market. If the City's Policy had been used in these funds (i.e. 90% bonds and 10% money market), then the overall return would have been 1.81% or 175 basis points less than the actual return of 3.56%. On an average portfolio market value of $819.0 million, (excluding One Fund Equity and bank account balances) the incremental return of 1.75% resulted in incremental revenue of $14.33 million. The One Fund's underperformance is attributed to its policy of investing only in short-term bonds, which underperformed longer term bonds given the interest rate decline in 2015. The decline in interest rates in 2015 was particularly beneficial to bonds with term to maturity over three years, as evidenced by the FTSE TMX All-Government Mid Index return of 5.11% and the FTSE TMX Short Government Index return of 2.54%.

Table 1 below summarizes the investment return indicators.

Table 1 - Investment Return Indicators (for information purposes only)

	12 Months ended 12/31/2015	**12 Months ended 12/31/2014**	**12 Months ended 12/31/2013**	**12 Months ended 12/31/2012**	**12 Months ended 12/31/2011**
Policy Target	2.72%	4.34%	0.42%	1.56%	5.76%
City's Portfolio	**3.56%**	**6.39%**	**-0.73%**	**3.06%**	**6.83%**
One Fund – Bonds	1.94%	2.91%	1.14%	1.55%	4.19%
One Fund – Money Market	0.67%	0.86%	0.95%	1.04%	1.19%
FTSE TMX – Short Government	2.54%	2.76%	1.40%	1.17%	4.62%
FTSE TMX – Mid Government	5.11%	9.11%	-1.20%	3.45%	10.20%
Bond Lending Revenue	$130,191	$115,803	$129,097	$85,206	$64,847
Earnings Rate (Excludes Capital Gains/Losses)	**2.83%**	**2.91%**	**2.81%**	**2.93%**	**3.33%**
City's Return One Fund Investment (Equity)	**-0.11%**	**25.09%**	**22.74%**	**14.49%**	**-7.71%**

The investments in the portfolio, excluding the One Fund Equity investment, consist of 100% bonds and 0% money market. During the year ending December 31, 2015, the interest rate earned in the City's bank account was greater than the interest rate earned on Treasury Bills and Banker's Acceptances (with term to maturity less than 6 months) and therefore, funds that were earmarked for short term expenses were held in the City's bank account. The City also continued to hold a modest amount of Floating Rate Notes, which continued to be a favourable alternative to money market securities. As at December 31, 2015, the duration of the portfolio was 4.29 years compared with 4.56 years as at December 31, 2014.

On December 31, 2015, the market value of the investment portfolio was $788,271,817 (excluding One Fund Equity and bank balances), a decrease of $22,115,984 compared to $810,387,801 as at December 31, 2014. No debt was issued in 2015, therefore incremental cash inflows were not received.

The restructured Asset Backed Commercial Paper (Master Asset Values) were sold in 2013, and all the remaining $10,000,000 of Devonshire notes were redeemed in 2014 at par. The CCAA reserves put aside and held by the court appointed Monitor- Deloitte totalled $68,795,861 net of expenses at December 31, 2015. The City of Hamilton's pro-rata share is estimated at 1.195% and ranges from the low subsequent distribution estimated at $1,547 and high of $774,471 depending upon expenses over the next 2 years.

As at December 31, 2015, the One Fund equity holdings market value was $5.315 million (or 0.67% of the market value of the Reserve Fund including the One Fund but excluding bank balances). Over the twelve month period ending December 31, 2015, the City's investment returned -0.11%. We expect to increase the City's investment in the One Fund's Equity Fund and possibly the Universe Bond Fund in 2016.

Table 2 below shows the changes in Canadian interest rates over the past 24 months.

Table 2

CANADIAN INTEREST RATES			
Canada Benchmark Bond	**Interest Rate January 4, 2016**	**Interest Rate January 2, 2015**	**Interest Rate January 2, 2014**
One Month (T-Bill)	0.46%	0.89%	0.87 %
2 year	0.47%	1.00%	1.13 %
5 year	0.73%	1.31%	1.93%
10 year	1.40%	1.74%	2.74%

Through 2015, short-term rates declined as did the Bank of Canada's target for the overnight rate which was twice cut by a quarter percentage point during the year, ending 2015 at 0.5%. Longer term rates tended to move progressively lower led by the 10 year and 30 year bonds. The decline was based on reduced inflation fears and reduced concerns of a rate increase by the Bank of Canada. As well, commodity prices particularly oil which opened the year at $54 a barrel before closing 2015 at $37 were moving lower due to slowing global activity particularly in China. This in turn led to increasing downward pressure on the Canadian dollar. The portfolio of bonds, in spite of having a high proportion of very short securities to fund delayed projects, performed better than the benchmark and the One Fund.

The Canadian dollar ended the year at $0.723 US, having closed 2014 at $0.861 US. This was due to decreasing projected global economic activity and a major slide in commodities especially oil prices.

The Canadian economy is at least temporarily perceived as being vulnerable to reduced exports and business investment. The current market for commodities remains weak and has led to a 0.25% reduction in the overnight target rate by the Bank of Canada to a target rate of 0.5% on July 15, 2015. The Bank cut expected GDP growth for 2016 to 1.4% from its projections during 2015 of 2.4%.